

General Information Letter: Deduction for claim-of-right items repaid by taxpayer governed by IRC Section 1341.

March 26, 1998

Dear:

This is in response to your letter of March 6, 1998. Department rules require that the Department issue two types of letter rulings, private letter rulings (**PLRs**) and general information letters (**GILs**). For your general information we have enclosed a copy of 2 *Ill. Adm. Code 1200* regarding letter rulings and other information issued by the Department.

Although you have not specifically requested either type of ruling, the nature of your questions and the information provided require that we respond with a **GIL**. **GILs** are designed to provide background information on specific topics, however, **GILs** are not rulings that are binding on the Department, but **PLRs** are binding on the Department.

In your letter, you inquire in part as follows:

Please accept this letter as a request for a ruling as repayment of items of income previously taxed as income in the following situation.

During the calendar years 1996 and 1997 my client reported as income \$11,235.12 for disability benefits received. Subsequently he was notified to repay this amount since the Social Security Administration paid him for this disability claim, which amount he reimbursed his employer in February of 1998.

The ruling I am seeking herewith is whether or not he can file an amended return for each of these years deducting the amounts reimbursed from his State of Illinois Income Tax Returns. Since all further income to him will not be taxable in the State of Illinois, being all from Pension and Social Security Funds. If not, how should the matter be handled?

In the case of an individual, base income means an amount equal to the taxpayer's federal adjusted gross income for the taxable year as modified with subtraction and addition modifications listed in Section 203(a) of the Illinois Income Tax Act. Pursuant to Section 203(h), "except as expressly provided by this Section there shall be no modifications or limitations on the amounts of income, gain, loss or deduction taken into account in determining gross income, adjusted gross income or taxable income for federal income tax purposes for the taxable year, or in the amount of such items entering into the computation of base income and net income under this Act for such taxable year."

With respect to recalculating Illinois taxable income as a result of repaying a part of a prior year's taxable income, an individual is allowed to

modify his or her adjusted gross income with a subtraction "equal to the amount of the deduction used to compute the federal income tax credit for restoration of substantial amounts held under claim of right for the taxable year pursuant to Section 1341 of the Internal Revenue Code." IITA Section 203(a)(2)(P). Federally, when an item was included in gross income for a prior taxable year (or years) because it appeared that the taxpayer had an unrestricted right to such item, and the amount of such deduction exceeds \$3,000, the taxpayer is entitled to either a deduction or a credit as you have indicated.

For Illinois income tax purposes, only a taxpayer who has taken a federal credit for amounts repaid under "claim of right" is entitled to the subtraction modification. If the taxpayer claims the deduction federally, no Illinois subtraction modification is allowed. Furthermore, if there is insufficient Illinois income available from which to deduct the full amount of the claim of right subtraction modification, the remaining modification amount is forfeited. There is no provision in the Illinois Income Tax Act to allow a carryover of an excess claim of right subtraction amount. Therefore, the only manner in which a taxpayer may "recoup" taxes paid on amounts held under claim of right is in the manner authorized by Section 203(a)(2)(P) of the Illinois Income Tax Act. While this may seem a somewhat harsh result, we are unable to administratively modify the clear terms of the Illinois Income Tax Act.

Your correspondence makes no mention of how this matter was handled for federal income tax purposes, so we cannot advise whether he currently qualifies for the subtraction. If he took the credit federally for the reimbursement made to the employer, he would be entitled to a subtraction equal to an amount which would have been deducted from income had the federal credit not been claimed. If he has not claimed the federal credit, he may wish to file amended U.S. 1040's for 1996 and 1997, so that he can qualify for the subtraction modification.

As we noted above, the foregoing discussion is a **GIL** and not a **PLR**. In order to request a **PLR**, it would be necessary to provide us with a request that complies with the requirements of *IIT Reg. Sec. 1200.110* of our rules.

Very truly yours,

Jackson E. Donley
Associate Counsel